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PP RUEHWEB

DE RUEHNR #3261/01 2090250
ZNR UUUUU ZZH
P 280250Z JUL 06
FM AMEMBASSY NAIROBI
TO RUEHC/SECSTATE WASHDC PRIORITY 3291
INFO RUEHXR/RWANDA COLLECTIVE PRIORITY
RUCPDOC/DEPT OF COMMERCE WASHDC
RUEHRC/USDA WASHDC

UNCLAS NAIROBI 003261

SIPDIS

DEPT FOR AF/E, AF/RSA

SIPDIS

E.O. 12958: N/A

TAGS: [ENRG](#) [ECON](#) [ETRD](#) [KE](#)

SUBJECT: Kenya Dodges Bullet; Adequate Rainfall Prevents Power Shortage

REF: NAIROBI 285

¶1. Summary: The April rains exceeded expectations, filling Kenya's hydropower reservoirs close to capacity and avoiding a recurrence of the power rationing in 2000 that cost the economy \$48 billion and cut GDP growth to 0.4% in **¶2000**. The 140 MW generators temporarily installed in case the drought persisted have raised power costs, but were not needed. Kenya Electricity Generating Company (KenGen) wants to retain the thermal capacity to diversify its sources, and hopes to recover the contract costs through power exports to Uganda. However, if export negotiations founder, the Emergency Power Supply Committee may cancel the contract with Aggreko and give up the thermal plants.
End Summary.

Drought Threatened Hydropower Generation in Early 2006

¶2. About 60% of Kenya's installed capacity of 1,085 megawatts is hydropower, and the shortfall of rain in 2005 reduced water levels behind the hydroelectric dams alarmingly by early 2006. The forecast of continued drought in 2006 raised fears of a recurrence of the drought of 2000, when a shortfall of over 400 Megawatts forced a power rationing program that cost the economy \$48 billion and cut GDP growth to 0.4% in 2000. In 2000, the GOK's contract with a foreign company to bring in emergency thermal generating capacity was criticized as too little, too late, and too expensive.

Kenya Prepared for Hydropower Shortage

¶3. To avoid a repetition of power rationing, Kenya established the Emergency Power Supply Committee consisting of the Kenya Association of Manufacturers, KenGen, parastatal Kenya Power and Lighting Company, the Electricity Regulatory Board, and the Ministries of Finance and Energy in early 2006 to get bids and negotiate a contract with an independent power producer to provide temporary thermal generating capacity. In March, the Committee signed a contract with British firm Aggreko to provide 220 MW of capacity on terms both less expensive and more flexible than the 2000 contract. The first 40 MW plant opened near Nairobi in May, and a 100 MW plant was installed in June, but did not begin operations. In June 2006, KenGen began charging consumers an average Ksh4.3kwh (6 US cents) surcharge to cover Aggreko's fuel costs.

Now Kenya's Dams Are Almost Full

¶4. Fortunately, the weatherman was wrong, and KenGen reports the April rains exceeded expectations. The water level at the main reservoir, Masinga Dam, is near capacity, just three meters below spillage. KenGen reports the dams downstream from Masinga on the Tana River are also near full capacity. Turkwell, the other main reservoir in the west of the country, is also at one of its highest levels, even before the main rains fall in that region. Kenya, which normally has to import 30 MW of power from Uganda, finds itself with a rare energy surplus. Unless the October rains fail badly, Kenya's power supply seems assured in 2006, and the emergency generators will not be needed.

Terminating Aggreko Contract Would Save Millions of Dollars

¶5. According to KenGen Managing Director Eddy Njoroge, terminating the contract and letting Aggreko remove the thermal plants would save consumers about Ksh1.8 billion/month (\$25 million). Treasury would also save the Ksh500 million/month (\$6.9 million) retention fee owed to Aggreko regardless of whether its generators were used. Termination would also release some Ksh5 billion (\$69.4 million) that KenGen had committed from its budget to finance the hiring of emergency generators, capital that could otherwise be used to expand and diversify Kenya's power sources.

Kenya's sources of electricity

¶6. Electricity demand in Kenya is estimated at 1,070 Megawatts, and is expected to rise to 1,520 Megawatts by ¶2009. Currently, 26% of Kenya's electricity is generated from thermal plants and 14% from geothermal and other sources. The government has announced plans to diversify sources using part of the Ksh7.4 billion (\$103.7 million) raised in the May flotation of 30 per cent of KenGen's equity at the Nairobi Stock Exchange. The capital will be used to establish a geothermal development fund and to fund prospecting for natural gas and coal. In addition, Woodside Oil is expected to begin offshore exploration drilling for oil in late 2006.

Export the Surplus Thermal Capacity or Relinquish It?

¶7. KenGen wants to retain the 140 MW thermal generators Aggreko installed to diversify its power sources and conserve hydropower reservoirs. KenGen hopes to export the surplus power to Uganda, which is suffering one of its worst energy shortfalls in recent years. EPC chairman Pradeep Paunrana said the EPC wants the export price set to allow KenGen to earn a small profit on the Aggreko investment and to help KPLC recover part of the technical costs of transmitting the power to Uganda. A KenGen source told Embassy the Committee has already signed a non-binding Memorandum of Understanding (MoU) with Uganda government to export surplus electricity. Press reports claim Uganda is demanding a lower price and moving the generators closer to the border to reduce transmission losses. KenGen's Njoroge said the Aggreko contract could be terminated after the October rains if no deal has been reached with Uganda. In any case, the expected growth in demand for electricity and the lack of sites for additional significant hydropower dams will require Kenya to develop thermal, geothermal, solar, or wind capacity.

Comment

¶8. Led by the private sector, Kenya did a creditable job of preparing for the threat of protracted drought and associated power shortages. Even though the drought ended, the case of Uganda demonstrates the value of paying for insurance. While the increase in already-high electricity

tariffs must have had some economic impact, Kenya is temporarily in an enviable position: its power sources are more diversified, it has a power surplus, and it is in a position to recoup some of its costs by exporting power to Uganda, which is facing a multi-year shortfall. While negotiations continue with Uganda, KenGen is waiting to see if the October rains fail to top off the hydropower reservoirs before the Committee decides the fate of Aggreko's thermal generating plants. However, this surplus is temporary, and Kenya knows it must build new power plants soon, or face shortfalls like Uganda. End comment.

Hoover